BUY ONE HOUSE, GET FOUR FREE!

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Every day clients phone my real estate brokerage here on Santorini Island wanting to buy or sell something. It is difficult for me because I am in the nasty position of being able to see the future a little clearer than most of my clients. No, I am not some sort of wizard, but if you want to give advice for a tiny piece of land, on a tiny island, in a tiny country, you have to look at the big, big picture. In a global economy, the micro is derived from the macro. Looking at the macro doesn't only mean keeping a close eye on the global real estate situation; it also means keeping an eye on something I call the hyper-macro -- the macro situation outside the limits of any particular industry.

By now, most people are aware of the economic crisis and, for many, it is affecting them personally. Still, few people understand the root cause of this crisis and people fail to realize that we are at the end of and era. The era which is ending is the era of false confidence in a fiat-based monetary system, a system which is the root of all our current economic dilemmas.

Up until recently, people rushed to the American dollar when there was no confidence in their own currency. This rush increased the value of the dollar. Since Nixon's closing of the "Gold Window" in 1971 however, the dollar became just a mere piece of paper costing 6 cents to print (whether it is a single greenback or a 100 dollar bill) with no intrinsic value and based on debt. There was nothing "hard" backing the currency, only the "confidence" bestowed to the world's largest economy. Yet when governments mismanaged their finances, people rushed to the mighty 6-cent note. But when they ran to the dollar, trade imbalances occurred which led to American current account deficits, the off-shoring of productivity and a bubble in credit due to the low cost of financing the highly sought after US debt. This credit bubble fuelled inflation in America which it later exported to the rest of the globe. The major problem here was that the value of the currency did not discount potential future inflation. Everyone still wanted dollars and the game continued. This changed, however, near the beginning of the millennium when the role of the US dollar as the global reserve currency came into question.

When people finally woke up and realized the dollar had fundamental flaws, they ran to the Euro, creating similar current-account deficits and inflationary problems here. There was even talk of the Euro being the next global reserve currency. But the whole "safe-haven" illusion of the Euro only lasted a little while. The grand illusion of the Euro needed just a few cracks in its hull to see how easy the whole ship could sink. When global de-leveraging began and when the black holes of global finance had to be plugged, people flocked back to the "safe haven" of the dollar. Huge holes in the structure of the Euro-zone negate any reasonable justification for the Euro as a global reserve currency. But does the dollar deserve to possess a "safe-haven" status?

Soon many of these chickens will have their heads cut off because, as these dumb chickens flock back to roost in the “confidence” of the world’s reserve currency, they fail to realize the true danger of what Nixon did almost 40 years ago.

De-leveraging continues. People are trying to pay down debt and are selling assets, sometimes good assets, in order to accomplish this. In some senses this is good. However, this de-leveraging is causing a deflationary spiral. Governments around the world are trying to combat this by lowering rates and by printing money. In order to protect exports and current account balances, they have begun a currency war and it is a race to the bottom. Trust in all currencies is fading but the trust in the American dollar is coming to an end too, even though we will see it rally over the next little while. But is the dollar actually rising? No, all these currencies are falling, just at different rates. Imagine dropping feathers down and watching them float to the ground in soft little race to the bottom. It is hard to tell which will be first to hit the floor, but be rest assured, they will all hit the floor. This is the curse of a fiat based monetary system. At the moment, the US dollar is still holding its head above the water as all try to save themselves from the sinking ship, but it is to no avail. The fed is impotent and broke. They are impotent due to the huge sums of Treasury and agency debt held by foreigners and they are broke by trading cash for trash.

The smart chickens have found their home to roost however and the smart chickens have flocked to gold. We can see faith in fiat based currencies being destroyed with the current rise in gold price in all currencies. In previous articles I have mentioned the attributes of gold as the ultimate currency but the important thing that we should know by now is that the future currency will be gold. It is not a matter of if, but when.

Benn Steil, Senior Fellow and Director of International Economics at the Council of Foreign Relations, in is May 2008 speech at the New York Hard Assets Investment Conference (see http://www.resourceinvestor.com/pebble.asp?relid=42919), predicts gold will be the currency of the future after the loss of confidence in fiat currencies. Now, I’m not fond of the CFR, but when someone from the CFR endorses gold, I know there is something fishy in the works and that they are planning something for the rest of us. In such a situation, I want to be on the right side of the trade. Mr. Steil talks about some modern gold standard with little or no government involvement where banks hold e-gold from which we would draw upon with little bank cards from anywhere in the world. Well, my current faith in banks is about as high as my faith in fiat currencies, so I think I would pass on this suggestion. However, I do think that something like the Lehrman and Mueller gold revaluation plan (see: www2.nationalreview.com/monetary.htm) can be deployed to end the crisis and reinstate global confidence with a gold backed currency. Their suggestion is not much different from the revaluation of gold done by FDR when he confiscated the people’s gold in 1933. Basically, they suggest a re-valuation of gold to the point where all debts can be paid off creating a new balance point and then backing all currency with gold.

And where is the balance point. Where would we have to price gold in US dollars to get us out of this crisis? One interesting point in the Lehrman/Mueller article is that the Fed’s loan to capital ratio is about 50-1, thus re-valuing gold reserves from 42.22

to 1000 will change this ratio to 7-1. Now, assuming that the Fed has a bunch of junk on its hands, then we might want to make this 1-1, or around USD 7000.

Now perhaps you may find this strange, but Japan just offered the IMF loan guarantees of 100 billion? In a period of global economic crisis, after a two-decade depression, why would Japan do this? Well we all know that the IMF was looking to reduce its 12 billion dollar fiscal deficit with a 400 ton gold sale. Well, I wouldn't doubt that this loan guarantee is backed by those 400 tons of gold. If they price this gold at 7000 USD per ounce they have created a nice little guarantee for Japan in order for it to offer such a large loan guarantee.

So, by looking at the macro, I can make some little predictions about the micro. If you want to buy a little house, on a little island, in a little country, my suggestion to you is to take the money you would have spent on that little house and plow it into gold. As gold rises and houses fall, you should be able to pull off a "buy 1 and get 4 (or more) free" special if you time things correctly. When gold is revalued (ie currencies devalued), asset prices will jump and you will be looking at 300 dollar crude oil, and much more expensive real estate. However I believe that there will be a short moment in time when your gold will get you the real estate bargains of a lifetime as people don't immediately take into consideration the macro events in their micro world.